

# **Alaska Seafood Industry Radical Surgery? or Slow Death?**

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The beginning of the third millennium finds the Alaska seafood industry in a global economy that requires fundamental and significant changes to remain a healthy and viable industry. Some sectors of the Alaska seafood industry are healthy and competitive because of recent economic transformations and provide us direction on solutions. The Salmon, herring, crab and other sectors of our fisheries are in dire economic straits after several years of downward spiral.

Momentum for change is rapidly mounting in some Alaska fisheries due to severe economic decline. Other fisheries are still sleeping hoping their fishery will escape the onslaught. If we look at The Bristol Bay salmon fishery and the Bering Sea roe herring fishery the future of the Alaska seafood industry will come into clearer focus. The lessons are instructive.

Bristol Bay saw the decline of the number of processors and processing capacity by 20 % this season. New West, King Triton, Inlet Salmon and Fishing Company of Alaska dropped out totally. Ward Cove, Peter Pan and Trident reduced their number of processing platforms. Hundreds of fishermen were cut loose and had to find new markets. Some processors did not take on new fishermen even with a low forecast. This was a new phenomenon. Other salmon fisheries such as SE and PWS have not felt the severe economic pain that Bristol Bay has and hence the pressure for change is not as overwhelming. But, beneath the surface the same economic forces are at work and soon the pain will spread to other salmon fisheries.

Permit prices in Bristol Bay dumped from \$ 95,000 to \$ 25,000 this fall (prices peaked at \$ 300,000 some years ago). Many permits and vessels are for sale but the buyers are limited. The Bristol Bay drift fleet of 1800 vessels shrank to 1550 in 2001 and is poised for another large shrinkage in 2002. Again, prices of permits and vessels have more modestly declined in other salmon fisheries, but collapse a la Bristol Bay is not far away.

Herring processing capacity in Togiak shrank this season modestly. The Gillnet fisher count radically declined this season in response to the low gross stock last year. The low market prices have discouraged many fishers and processors north of Togiak and participation has dropped severely. Processors only bought 40 % of the roe herring quota due to depressed market prices and lack of profitability. The market price is so low and the existing cost structures so high; processors can not make the fishery work any longer. No one is farming roe herring. What happened? The reasons are myriad and run deep below the surface.

## **US Seafood Economics are Permanently Altered**

To reconstruct the Alaska seafood industry it is essential to understand the successive waves of change that have hit our shores. These changes are for the most part irreversible and many of these change forces will continue to play out and demand further reactions. The most fundamental changes are:

- a) The strong US dollar has allowed lower cost seafood to enter the US market and compete while our seafood exports prices have been decreased by the weak buying power of our overseas customers.
- b) The dramatic expansion of aquaculture, especially in salmon, has reduced seafood prices and redesigned the market place with new products and attributes.
- c) The sustained 12 year recession in Japan, where 60 % of Alaska seafood products sell, Has depressed demand and prices of our primary customer.
- d) Globalization has presented Alaska fishermen and processors with low cost competitors.
- e) The entry of Russia into the world seafood market with the same products as Alaska has Increased supplies of competitive products with third world cost structures.
- f) Food costs have continued to decline worldwide over the long-term dragging down seafood prices.

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### **Strong Dollar Reduces Revenues**

The strong US dollar has reduced the value of US exports of seafood. The majority of Alaska seafood is exported to Japan, Europe, Canada and other Asian countries whose currencies have declined in value compared to the dollar. The corollary is that our foreign seafood competitors can also import their products to the US market at lower prices. Several specific examples are instructive. Chile experienced 18 % erosion in currency value this year against the US Dollar allowing Atlantic salmon and other seafood exports to wash up cheaply upon our shores. Alaskan fishermen and processors must compete against Canadian salmon, halibut, roe herring, sablefish, cod and many other identical species and yet the Canadian Dollar is only worth two-thirds of our dollar. The Euro since its issuance has declined as much as 30 % reducing our customers buying power.

### **Aquaculture takes Over the Market**

Aquaculture has dramatically changed the landscape for the seafood industry by generating a new source of seafood. Aquaculture has grown from 19 % of the world seafood supply a decade ago to 31% currently and will steadily grow. Farmed salmon has grown from a dimple to commanding a 60 % market share in the world salmon market in the last decade. Farmed shrimp, catfish, tilapia and others have experienced similar growth rates and market dominance. Farmed salmon and other species have set new industry standards for quality, availability, predictability and freshness.

An oversupply of farmed salmon has collapsed salmon price globally. Some believe once this glut has worked its way through the marketing python that salmon prices will recover. An in depth study of current prices, current farmed salmon costs and future growth and cost plans reveal that price recovery will only be slight and belated. Five years from now the current salmon prices will return and salmon farmers will be profitable again. What has happened in salmon will occur in other species in decades ahead.

### **Japanese Buying Demand and Power Declines**

Japan has been and still is our largest and strongest customer for Alaska seafood products. The strengthening of the Japanese Yen over the last thirty years until the trend reversed in 1996 was a powerhouse driving Alaska fish prices. As the Yen strengthened from 300 Yen to the dollar to 100 Yen the Japanese buying power went up. As the Japanese economy boomed consumers and businesses expanded rapidly and bought products and companies all over the world that suited their desires. This caused the steady inflation in Alaska fish prices until the Japanese “Bubble Economy” burst in 1989 and started slipping downwards and accelerated into recession in 1997 and 1998. Japan buying power and the strong Yen no longer drive Alaska fish prices with a fever. With the boom gone higher-end products produced in Alaska such as herring roe, smoked salmon, salmon sujiko roe and king crab have declined in demand and price in Japan. Nearly every Alaska fishery has been negatively impacted by the Japanese economic decline.

### **Globalization Increases Low Cost Competition**

Globalization causes the movement of seafood products from the lowest cost producing area of the world to the highest value market. Similar products rapidly substitute when prices rise for a given product and create and opportunity for a substitute. If Alaska opilio crab prices go up, then East Coast Canadian, Greenland or Russian opilio crab will move in to fill the void at lower prices. Globalization means exchange rates matter more significantly to buyers and sellers. When products were produced and sold in the same country on an internal basis, exchange rates were a small factor in business. Swings in exchange rates translate to value changes for us immediately and significantly.

Reprocessing seafood is moving to the low cost third world producers. This year Chicken of the Sea moved its canning of boneless and skinless canned salmon from the US to Thailand and changed its raw product supply from Alaskan to Russian pink salmon. This was in response to its primary competitor Bumble Bee canning Russian pinks in Mexico. The lower cost product from Bumble Bee drove the change by Chicken of the Sea. This dynamic occurs each year in different markets and for different products.

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Chile entered the farmed salmon business with fresh and frozen headed and gutted salmon. Next, Chile moved to fresh and frozen fillets. Now, canned salmon, sashimi loins, smoked salmon and grill marked portions are shipping direct from Chile. All of this occurred in a ten-year time span. Technology moved to the location that could produce the product the market demanded at the lowest cost. Chilean labor costs are 10 % of US costs.

In all developed economies in the world, retailers and distributors are consolidating into larger and fewer players in each business segment. Computers, improved communication, improved transportation and better management systems provide the opportunity for larger players to develop that are more efficient than smaller players. These larger retailers and distributors are wielding greater market clout. Fragmented sellers and producers become price takers. Fragmented producers and sellers do not have the market clout to fight back with these gigantic buyers. Costco, Wal-Mart, Safeway, Sysco, Alliant and other giants in the retailing and distributing segments are calling the shots and dictating prices.

These drivers are changing many basic industries, especially the food business. Orchards in Eastern Washington are being plowed under because of foreign fruit in China and Chile. Potato farmers in Idaho are selling significantly below cost due to imported potato products. The US government is paying millions per month in storage for surplus sugar that exceeds market demand. There are many theatres for us to divine lessons and trends from in the globalization sweep of change.

### **Russian Products Compete Cheaply and Effectively**

After the political changes in 1989, economic changes followed in the fishing, production and marketing of Russian seafood. Many of the identical products Alaska produces and markets suddenly found a new competitor on the world market. With the decline of the Russian economy and the value of the ruble, Russians were able to produce seafood products identical to Alaskan products at much lower costs. With a strong economic imperative to capture Yen and Dollars from export, Russia turned to the export of seafood that had been traditionally consumed in the Soviet block – canned salmon, frozen salmon, salmon roe, pollock fillets, pollock roe, cod, crab, shrimp, halibut etc.

### **Food and Protein Competitors Lower Costs & Prices**

We need to broaden our view of the changing economics of food (and our fisheries) in world economics. The price of food in the world has continuously declined in the last two centuries. Examine the percentage of your family budget that goes to the supermarket for food. It is much less of the family budget than any time in history. The price of food on an inflation-adjusted basis has dropped 90 % since 1800.

A review of the change in cost of the production of chicken in the US gives us an idea of what our protein competition in the food market is all about. Dramatic change in efficiency and cost has revolutionized the chicken industry and chicken consumption. In 1952 the consumption of chicken was 9 pounds per capita annually in the United States. Four decades later consumption was 800 % higher at 72 pounds per capita. The change in consumption was driven by dramatic changes in costs at the production level:

	<b><u>1952</u></b>	<b><u>1995</u></b>
Weeks to Grow a Chicken	15	8
Pounds of Feed per Chicken	15	8
Avg lb. Size of a Chicken	3	4
Manhours to Process 100 lbs	5.1 hours	8 minutes
Cost of Production per lb	\$ 1.09	\$.50

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Tyson Chicken Sales

\$ 1 Million

\$ 6.4 Billion

Other food and protein competitors on the global food stage have achieved similar changes in economics. As seafood producers we must ask ourselves what changes we are going to make to effectively compete.

### **The Challenge to Become Economically Competitive**

We must face the need for significant institutional changes in the competitive structures of the Alaska seafood industry. We cannot turn the clock back a decade to the good old days of high priced Alaska seafood with buyers clamoring to buy our products. It is a buyers market with many low cost alternatives of very high quality seafood and other proteins. We must examine strategies that will improve our competitiveness in the global seafood market and provide structures and systems that can continue to evolve in the future to remain competitive.

Alaska fisheries can be divided into two general groups – those that are currently economically healthy and viable and those that are undergoing severe economic stress. The healthy fisheries are typified by recent government intervention to provide for economic rationalization – pollock, halibut and sablefish. Those fisheries under severe economic duress have not been rationalized in recent times – salmon, herring, crab and other bottomfish.

### **Rationalization Can and Does Work**

Halibut and sablefish fisheries were rationalized in the fishing sector in 1995 and hence those fishermen are recording viable and profitable fisheries in both state and federal fisheries. In 1999, the American Fisheries Act rationalized both fishing and processing sectors of the industry for pollock and secondarily to cod and other bottomfish resources. The CDQ program was established in 1992 and expanded with the AFA in 1999. These sectors of the industry with recent rationalization are economically healthy and competitive in the current world seafood market.

The American Fisheries Act reduced capitalization in fishing and processing sectors and reworked the rules to allow the pollock industry to become more efficient. With the new framework fishers and processors were able to make assets more productive, harvest higher value fish, attain higher recoveries of saleable products, reduce production costs and increase quality of products. These multiple changes allowed the pollock industry to be profitable despite all the dramatic changes affecting other seafood sectors in Alaska.

Halibut and sablefish fisheries from fishermen's point of view continue on a strong economic footing. There has been a reduction in fleet size. There has been consolidation of greater volumes per owner and per vessel. Fish supply has been spread out over time to the market place to command a higher price with more marketing options. Quality of products has improved with the ability to change fishing timing and strategies. Fishermen have been able to reduce their cost of fishing and increase their take home pay. For these species, the benefits of rationalization have offset the negative factors of the strong dollar and foreign competition.

The CDQ program is financially viable because the owners of the fish quotas are able to control the catching and landing of the fish and seek the most economic harvesting and processing methods. Rationalization in other countries can also supply us with other models of change and benefits. The Canadian roe herring fishery has been rationalized for fishers and processors and significant economic benefits have accrued. This is one reason Alaskan roe herring fishery is no longer economically competitive.

### **Actions to Restructure & Become Competitive**

Global economic changes demand that our industry change our cost structure if we desire to compete and sell our products in the world market place. We should not feel unique. The same global economic forces

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impact the American agriculture industry and other resource industries. In Eastern Washington beautiful fruit orchards are being plowed under to make way for Chinese orchards. In Idaho potato producers stare at large inventories that cannot compete against potatoes produced by Canadians across the border with devalued currency. Agricultural subsidies by the US government are the primary survival mechanism for American farmers according to recent national studies.

To change our cost structure and compete successfully in the world market place, we need to start thinking in new ways. Here are some ideas to consider:

- 1) Industry members and government policy makers must recognize that the Alaska Seafood Industry faces long-term economic challenge that requires fundamental economic rationalizations to develop competitive cost structures.
- 2) The “Alaska Seafood Crisis” includes salmon, herring, crab and other fisheries that have not been rationalized recently, not just distress salmon fisheries in Western Alaska.
- 3) The “Alaska Seafood Crisis” is an economic disaster in some areas of Alaska now and will be for other coastal Alaska area and includes all sectors – fishermen and crews, tenders, processors, workers and communities.
- 4) Alaska fisheries dramatically vary and solutions must be crafted to fit each distinct fishery by geographic region. For example the solutions to Bristol Bay salmon may differ from Norton Sound herring, SE Salmon and Bering Sea opilio
- 5) The historical patterns of timing, method of harvest and seasons are driven by habit. All industries must be able to change as circumstance change. Greater consideration has to be given to the economic and quality consequences of fishing, tendering and processing costs in these decisions.
- 6) We need to give consideration needs to a more level production of species such as pink salmon where erratic volumes have depressed market values. Alaska seafood must become market not production driven.
- 7) To reduce costs and become more cost competitive we must reduce Capitalization in all sectors – fishing, tendering and processing. There are many options to analyze and consider:
  - a) Buybacks of fishers and processors
  - b) Consolidations
  - c) Stacking of permits
  - d) Establishment of Co-ops
- 8) For many years there has been a hue and cry for marketing of salmon and new products as the panacea to the ills of low salmon prices for fishermen. We must realize that marketing of seafood and the development of new products are critical to staying in tune with the market and changing as consumers needs and desires change. But, marketing and new product development does not address the sweeping change in food costs, the dramatic change in the exchange rates, the ascension of third world countries as seafood competitors and the accelerating pace of change scientific advances have brought to aquaculture.
- 9) Should we get on the Federal agricultural subsidy bandwagon to survive? – (The US government has injected massive subsidies annually to keep American agriculture alive and competitive. Federal subsidies have been supplied 50 % of the annual profits of the US agriculture industry.)
- 10) Alaska marketing co-ops would need exemption from anti-trust laws to be legally allowed. For example, a canned pink salmon marketing co-op could help stabilize prices and provide a stable platform to market products from.

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### **How Will Change Come About?**

Change is about pain. We fear change because of the unknown features of change and the pain it might bring. Change brings an unknown future. We are more comfortable with the known pain of today, rather than the unknown of the future. When the pain of our current economic downturn increases and tips the scales and appears to be less than the pain of the unknown, we will finally dive into the pool. How much pain does our industry need to experience before we are ready to navigate the unknown waters of our future?

Change will not be easy. The seafood industry is fragmented. We are populated by thousands of fishermen, many different fisheries and myriad processors. We are sprawled over thousands of miles of coastline with complex and diverse regulations and histories. We are an industry of fierce competitors, buccaneer egos and self-made individualists.

But, change has been accomplished before in our industry and it provides us with the model for how we can bring about change again.

In the 1970's leaders of fishermen and processors presented plans and ideas supported by a consensus of the industry. Out of these efforts in Alaska came the Limited Entry System, the Alaska Seafood Marketing Institute, the Alaska salmon hatchery program, and the federal creation of the Magnuson-Stevens Act and the 200-mile limit. These and many other changes and programs assisted the industry in a rising tide of expansion and economic prosperity. Later the IFQ, CDQ and American Fisheries Act followed proving our industry can forge consensus, gain government support for change and implement new programs creating broad based economic reform.

At this juncture leaders are needed to step up representing the various segments of the industry. A forum needs to be established to have serious discussions and a goal established to develop a broad based consensus for change. Without a broad base of consensus any plans for change are dead on arrival. Government leaders are not going to step in and sort out an industry consensus. Government can assist and facilitate but not lead the change that is needed in the seafood industry.

### **Are we ready to change?**

Do we need another round of bankruptcies, losses, permit prices dropping, asset values declining and another Governor's disaster proclamation? The Bristol Bay salmon fishery is painting one picture of change by natural economic forces of bankruptcy. The pollock fishery and the American Fisheries Act demonstrate there is an alternative. `